SECRET

Chrono

THE DIRECTOR OF
CENTRAL INTELLIGENCE

National Intelligence Council

12 November 1985

NOTE FOR: [redacted]
Executive Secretary

25X1

FROM: [redacted]
Acting NIO for Economics

25X1

SUBJECT: Attached Talking Points

Attached are the economic sections of the DCI's briefing book.

[redacted]

25X1

Attachments:
As Stated

25X1

12 November 1985

The Iran-Iraq War: Impact on the World Oil Market

Iraq's recent attacks on Khark Island reflect a decision by Baghdad to seriously reduce the oil-loading capabilities at Iran's main crude oil export terminal enough to curtail Tehran's financial ability to continue the war.

-- Iraq has attacked Khark Island more than 30 times since mid-August.

By late September Baghdad had inflicted serious damage on Khark's export facilities and significantly reduced Iranian oil exports.

-- The T-jetty was knocked out of operation during mid-August, and the sea island terminal was seriously damaged in late September.

Since late September, however, ineffective Iraqi airstrikes have allowed Tehran to partially repair some of the damaged facilities.

-- Four of ten T-jetty berths have been returned to service, and the sea island is undergoing repairs.

-- As a result, Khark exports are at levels sustained prior to the recent series of attacks, and some surplus capacity may soon be available.

Nevertheless, Iraqi intentions to continue airstrikes against Khark leave open the possibility that all exports from the island could be halted.

-- Senior Iranian political and military officials have warned that Iran will retaliate against Iraq's allies and stop the flow of their oil from the Gulf if Tehran's oil exports are stopped.

The Iranian Response

Tehran has numerous options to respond to the Iraqi attacks while controlling the level of escalation to prevent drawing Western powers into the conflict.

-- [redacted] STAT Iranian military aircraft and helicopters could raid selected oil-related economic targets--particularly

25X1

 25X1

[redacted]

Iran-Iraq War (continued)

oil loading facilities--near the coast of the Gulf States. Despite combat losses and shortages of parts, Iran has about 70 operational fighter aircraft, sufficient to carry out sporadic, small-scale raids that could inflict significant damage anywhere in the Gulf.

-- Tehran could initiate commando raids against oil facilities near the shore of the Arab Gulf countries.

-- Tehran also could sponsor terrorist attacks on oil-related facilities.

-- The Iranians have also maintained or improved their capabilities to attack or seize shipping in the Gulf over the last two years.

-- Iran has sufficient air and naval forces in the area to enforce a blockage of the Strait of Hormuz against unarmed, unescorted cargo ships and tankers [redacted] STAT

The Iranians are unlikely to try to close the Strait of Hormuz as long as Iran can export some oil and receive imports. Closing the Strait would provoke a confrontation with the West, a situation Tehran hopes to avoid.

Impact of an Oil Disruption

Although we believe the probability of a major oil disruption remains low, the risk has increased as a result of Iraq's decision to press airstrikes against Khark Island.

-- The impact of an interruption of Persian Gulf oil exports would depend on its severity and duration, the availability of supplies from other producers, and the use of petroleum stockpiles.

Surplus available capacity is more than sufficient to offset the loss of Iranian, Iraqi, and Kuwaiti exports.

-- Although other countries could replace these lost supplies by raising output, much of existing global surplus capacity would be eliminated, however.

-- Spot prices would likely rise if buyers anticipated a further spread of the conflict.

-- As long as Saudi export capabilities remain intact, however, oil supplies should be adequate to prevent a major increase in prices.

12 November 1985

The Administration's Position on World Trade

The US government is pressing for reduction of trade barriers and elimination of foreign unfair trade practices. At the same time, the large US trade deficit and major foreign penetration of US markets--notably shoes, clothing, steel, and semiconductors--are generating strong US protectionist pressures, particularly in the Congress, that may be difficult to hold in check.

The President's trade action plan, announced in September, provides the major elements of the Administration's effort to control domestic protectionist pressures while also protecting legitimate US trade interests. As part of the plan:

(1) An interagency Strike Force has been formed to identify unfair trade barriers and recommend actions to eliminate them.

(2) The United States is pushing for a new round of multilateral trade negotiations in GATT.

(3) The United States will continue to explore bilateral and regional trade arrangements. The US has been actively encouraging Japan, South Korea, and Taiwan to reduce barriers to US exports, and is investigating free trade or sectoral free trade arrangements with ASEAN countries and with Canada.

(4) The Administration is self-initiating several "Section 301" actions to penalize countries undertaking unfair trade practices.

(5) The Administration has requested Congress to approve $300 million to fight predatory use of mixed export credits by our trading partners.

(6) The beneficiary status of developing countries under the Generalized System of Preferences is being reviewed, taking into account openness of their markets to US goods, services, and investment, and the degree of protection afforded intellectual property rights.

(7) A bipartisan Presidential commission on international trade and economic policy will be formed. It will assess adequacy of US trade laws, evaluate the GATT, and advise on US international economic policy.

25X1

The Chinese are primarily concerned with the possibility of restrictions on textile imports and, in particular, the Jenkins Bill. China exported about $400 million worth of textiles directly to the US in 1984, and the Jenkins Bill calls for a 65 percent reduction in these sales. The bill passed the House in October, but by less than the two-thirds margin needed to override an anticipated Presidential veto. Indeed, Congressional support for the bill has slipped substantially since the Administration took a more active stance on trade. In addition to trying to defuse Congressional action on the Jenkins Bill through the President's trade action plan, the Administration will push for a renewal of the Multifiber Arrangement (MFA) which establishes guidelines for negotiation of bilateral textile and clothing agreements.

12 November 1985

The World Debt Situation and the US Position

Treasury Secretary Baker announced a new US plan for strengthening the international debt strategy at the IMF/World Bank annual meetings in Seoul last month. The Baker initiative proposes a three-point "Program for Sustained Growth." It calls for:

-- debtor countries to adopt macroeconomic and structural reforms to promote long-term growth and balance of payments adjustment and to reduce inflation;

-- the World Bank and Inter-American Development Bank to take on larger roles in the debt strategy to facilitate longer-term adjustment; and

-- commercial banks to increase lending to support comprehensive economic adjustment programs in debtor countries.

The initiative proposes that creditors provide the 15 principal debtor countries with access to a total of $29 billion in new funds from commercial and multilateral development institutions over the next three years. The intended flow would represent a reversal of the recent downward trend in net lending to these countries.

So far, most members of the international financial community have welcomed the US initiatives on debt, applauding the more active US leadership, the new emphasis on developing country economic growth, and the increased role of the World Bank. At the same time, however, many question whether the US proposals--including new commercial lending and increased World Bank support--can be implemented. Some feel these measures are inadequate because they do not provide enough money to meet debtor financing needs for the next three years and do not reduce the level of LDC debt.

The success of the US initiatives will depend upon several developments that will begin to unfold during the next few months.

-- The nature and outcome of upcoming negotiations by major debtor countries--like Mexico and Brazil--with the IMF. Although Mexico has stated its intentions to work with the IMF, Brazil continues to avoid Fund recommendations.

25X1

-- The willingness of commercial banks to lend $20 billion in new money to the 15 debtor countries over the next three years. Large money center banks, although balking at fast approval of Baker's request for more lending, are likely to agree to the proposal in the coming weeks. Some smaller US regional and foreign banks, however, may opt out.

-- The willingness of debtors to implement the policy reforms proposed by Secretary Baker. In our view, it is unlikely that the Baker plan will entice Brazil and Mexico to take the political risks associated with implementing comprehensive economic reforms.

12 November 1985

Discrepancies in US-PRC Trade Data and the US Position

For several years Washington and Beijing have disputed each other's data on their bilateral trade. In 1984, for example, the US data show the United States in surplus by $64 million while Chinese data show a US surplus of $1,278 million.

In our view there are three main reasons for the discrepancy: procedures for recording the country of consignment, differences in types of transactions recorded, and the enforcement capabilities of each country's customs administration.

-- Indirect trade between the United States and China through Hong Kong accounts for roughly half of the discrepancy. Both the United States and China attempt to determine the ultimate country-of-origin of the imports. Neither the United States nor China, however, can easily track the ultimate destination of their exports, particularly in the case of entrepot trade destined for the United States through Hong Kong.

-- Chinese trade data overstate merchandise imports from the United States by including certain "invisible" items that should show up under the category of services. For major shipments of capital equipment, Chinese customs appears to lump the value of the merchandise together with the blueprints, knowhow, training, and other associated services in an all-inclusive category for "complete plant and equipment."

-- Finally, in order to evade China's foreign exchange controls--in particular, the requirement to remit all foreign exchange earnings to the Bank of China--we believe Chinese organizations probably underinvoice exports and overinvoice imports.

The Chinese view the trade balance as a serious matter and brought it up several times during Vice President Bush's trip. Although they do not believe that bilateral trade must be balanced, they argue that the United States has not done enough to promote imports from China. They are particularly disturbed by what they see as increasing protectionism in the United States, and they see the Jenkins Bill to limit textile imports as a serious threat. Indeed, they have threatened to cut back their own imports from the US if the bill passes. Because of the highly centralized nature of China's foreign trade system, Beijing has the ability to link import and export decisions and has used that ability frequently in the past.

25X1

CONFIDENTIAL

Sino-US Trade, 1984 (in million US$)

	US Exports to China f.o.b.	US Imports from China f.o.b.	US Surplus f.o.b.
US data	3,004	2,940	64

	PRC Imports from US f.o.b.*	PRC Exports to US f.o.b.	US Surplus f.o.b.
Chinese data	3,595	2,317	1,278

* The reported Chinese data have been adjusted from a c.i.f. value basis to an f.o.b. basis to make the data comparable with the US.

12 November 1985

US Economic Developments and Policies

The United States has experienced a substantial economic recovery since 1982; a recovery that is already in its 34th month and shows every sign of continuing.

-- The Federal Reserve has been successful in keeping the inflation rate down. Inflation is running at about 3.5 percent for 1985 and, more importantly, wage rates increased only slightly during the third quarter and will register about a 3 percent increase for 1985 as a whole.

-- GNP is now 13.4 percent above its 1982 trough, resulting in a substantial decline in unemployment.

-- Business fixed investment increased sharply in 1982-1984 period as a result of a decline in borrowing costs and rapid growth of aggregate demand.

This strong US performance has been the driving force behind world economic recovery.

-- The large US trade deficit--largely a result of a loss of competitiveness associated with the strength of the US dollar--was the major reason behind the surge in LDC exports in 1984.

-- The strong US dollar attracted large amounts of foreign capital and reflected foreign investors' confidence in the US economy.

Most analysts believe the US recovery will continue over the next 12-18 months. The CEA is forecasting an increase in GNP of about 4 percent in 1986. CEA analysts argue that foreign trade and inventory adjustments, which slowed growth in 1984, will be less of a negative influence in 1985.

-- The 15 percent decline of the dollar this year should present a further worsening of the trade balance.

-- The inventory decline appears to have ended.

The key uncertainties are (a) the continued growth of consumer demand in the face of small wage increases, and (b) the possibility of a financial crisis brought on by foreign debt problems, a precipitous decline in oil prices, or farm credit difficulties.

25X1